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Behind Mobil's Maverick Moves
In Partial Defense of David Stockman

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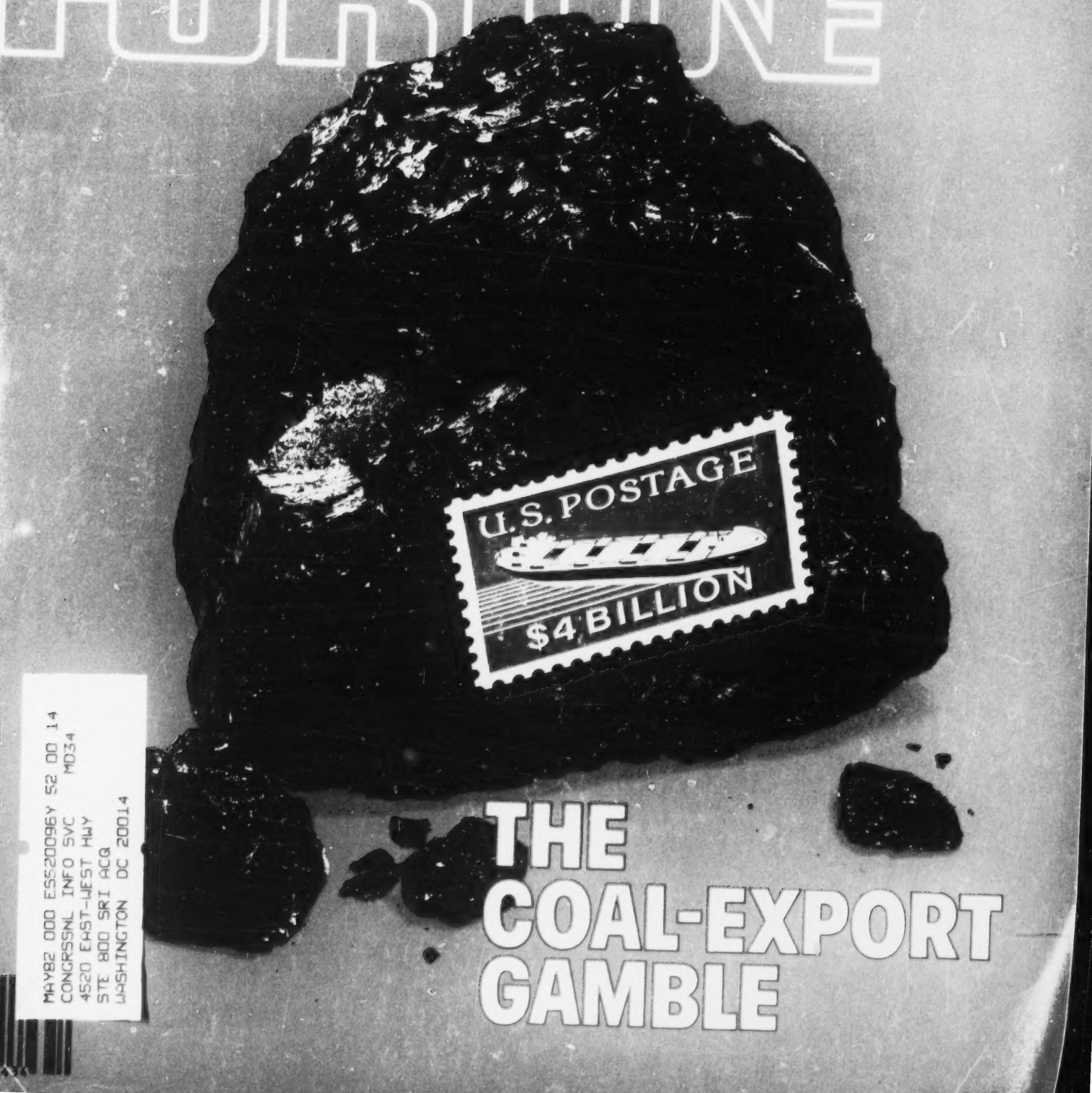
December 14, 1981

FORTUNE



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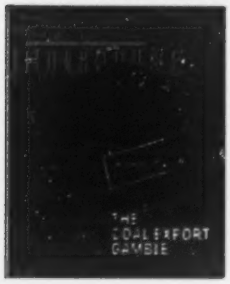
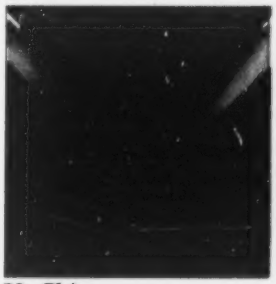
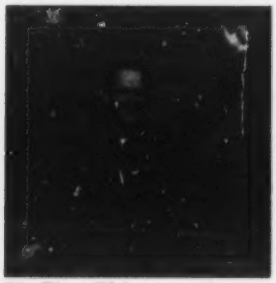


Nicholas Fasciano designed the $4-billion stamp on the cover to signify the enormous investment going into new coal terminals at U.S. ports. Frank Spinelli took the photograph. An article on coal fever begins on page 122.



52 Chips



70 First Chicago

89 Stockman

Departments

4 THE EDITOR'S DESK

7 IN THE NEWS
Con Ed finds favor at last, **American Airlines** joins the pay-cut rush, **Grumman**'s chancy joy, the surprising revolt at **Penn Central**, the hot cars are the high-priced ones, **Connecticut General** and **INA** get together—and more

27 LETTERS TO FORTUNE
On corruption in the Third World, the role of luck in shaping careers, Chile's police state, and other matters

41 FORTUNE FORECAST
A mild recession has arrived

Swifter depreciation buoys capital spending

ACKNOWLEDGMENTS

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December 14, 1981

93 Mobil

98 Enterprise zones

47 KEEPING UP
The *Washington Post* goes straight, a nuclear non-event, thin Episcopalians, and other matters
by Daniel Seligman

151 PERSONAL INVESTING
The looming boom in beepers and car phones
by Aimée L. Morner

159 BOOKS AND IDEAS
Jock Whitney and the rich man's burden
by Andrew Hacker

165 BED AND BOARD
A hotel (with a health club) for Wall Street
by Peter Nulty

173 OFFICE HOURS
Coping with a liberated secretary
by Walter Kiechel III

TECHNOLOGY
52 Japan's Ominous Chip Victory *by Gene Bylinsky*
What an American executive calls "the thing we were all dreading" has happened in the 64K computer-memory market.

PICTURE PORTFOLIO
60 Silicon Valley's Changing Harvest
Semiconductor production is moving out, but new products assure the place will stay a high-tech mecca.

BANKING
70 The Hard Road Back at First Chicago *by Susie Gharib Nazem*
The new chairman aspires to be the bank's Vince Lombardi, but he's way behind on the scoreboard.

INDISCRETIONS
89 In Partial Defense of David Stockman *by Daniel Seligman*
Thoughtful readers of that *Atlantic Monthly* article will find loose talk, but not duplicity.

COMPANIES
93 What Makes Mobil Run *by Alexander Stuart*
A chronic shortage of crude helps keep Big Oil's biggest maverick combative.

POLICY
98 Reaganizing the Inner Cities *by Lewis Beman*
Enterprise zones are the Administration's way of helping its least natural constituency.

FOLLOW-UP
109 The Tax-Credit Trade Soars *by Richard I. Kirkland Jr.*
Deals arising from that lease-based loophole are tough to price, but more than $2 billion has changed hands since August.

ENERGY
122 The Coal-Export Gamble *by David Fairbank White*
Competitors are shoveling money into port facilities, some of which seem sure to be superfluous.

ENTREPRENEURS
139 Itel's Daredevil Alumni *by Shawn Tully*
Dealmakers' U. went belly up, but the spirit lives on.

MULTINATIONALS
142 Bad News Brewing in Brussels *by Richard I. Kirkland Jr.*
Managers operating in the Common Market may soon be forced to accept "worker democracy" that could snafu global planning.

ENERGY

The Coal-Export

Competitors are investing in shipping facilities as if the demand were unlimited.

by DAVID FAIRBANK WHITE

The forecast is stunning: by the year 2000, most experts agree, U.S. shipments of coal abroad will exceed today's colossal exports of grain. Demand has already grown so strong that a frustrated armada of colliers was kept at anchor off Hampton Roads, Virginia, this year, waiting months to load coal for Europe and Asia. Hoping to prosper from the coming trade, U.S. ports are launching their fastest and most dramatic expansion of export capacity ever. Total investment in new coal terminals could reach $4 billion as the ports make changes unparalleled since the container revolution lifted the face of waterfronts.

Coal fever has hit the coasts with such a wallop, in fact, that what was once a critical shortage of loading complexes now shows all the signs of becoming a glut. Across the country, 45 new terminals are being built or planned at 29 harbors on three coasts; if they are all completed, U.S. coal-loading capacity will top 625 million tons per year. This vastly exceeds even the Department of Energy's bullish projections that 250 million tons will be shipped overseas annually by the turn of the century—a 342% increase over today's level. (These export projections and figures on terminal capacity exclude the Canadian trade; Canada will buy some 15 million tons of U.S. coal this year and isn't expected to increase imports much.)

"I'm assuming somebody in these businesses has been doing some market studies and knows what he's doing," says Baltimore's port administrator, W. Gregory Halpin. As aggressive a port developer as any in the nation, Halpin is himself hardly immune to coal fever. Baltimore has 14 million tons of export-terminal capacity and is building 22 million more. "I have only one comment," says Halpin in his modern office high above the harbor crescent. "Ship it through Baltimore."

Grow or die

Many proposed terminals will probably never be built, and some on the Mississippi may earn their basic income on domestic traffic. (About 740 million tons of coal will be consumed in the U.S. this year.) But the temptation to overbuild seems irresistible. Coal companies, railroads, barge lines, terminal builders, and local governments all want to profit from the export business.

Each entity has its own special stake in the outcome. For the authorities that run the harbors, coal shipments mean jobs, income for local businesses, tax revenues. For big coal companies, terminals ensure that their product can move. For railroads and barge lines, the race is to protect their traditional livelihoods and to expand their markets. Each competitor is driven by the desire to grow and the fear of dying.

Entering the business for the first time, the Virginia Port Authority, a government body, will put up 25 million tons of capaci-

John McGrail

Occidental Petroleum expects to export 12 million tons of coal a year from this terminal going up in Baltimore. The elevated conveyor will feed coal from hopper cars into the stacking tubes. As coal rises in the tubes, it will spill out the windows into mounds. Conveyors under the holes in the ground will carry it to the loading pier.

Coal
U.S. Coal Port Capacity
in millions of tons per year
Existing
Under construction
Proposed
Granite Point, Alaska — — 24
Seward, Alaska — — 1
Bering River, Alaska — — 1
Bellingham, Wash. — — 6
Possession Sound, Wash. — — 15
West Tacoma, Wash. — — 7.5
Kalama, Wash. — — 15
Astoria, Ore. — — 9
Portland, Ore. — — 12
Sacramento, Cal. — — 3
Stockton, Cal. 1 — 4
Redwood City, Cal. — — 10
Los Angeles 3 2 20
Long Beach, Cal. 3 3 15
Existing
Under construction
Proposed
Mobile 10 13.5 —
New Orleans-Baton Rouge 40 30 49
Port Arthur, Tex. — — 2
Galveston, Tex. — — 6
Existing
Under construction
Proposed
New York — — 24
Eastern Hills, Pa. — — 3
Camden, N.J. — — 7
Philadelphia 4 6 —
Wilmington, Del. — — 7.5
Baltimore 11 22 25
Hampton Roads, Va. 51 12 79
Morehead City, N.C. 3 — —
Charleston, S.C. — 3 9
Savannah, Ga. 3 20 16
Brunswick, Ga. — — 15
U.S. TOTALS 132 111.5 385

Coal Fever on the Coasts

This FORTUNE survey of ports (orange dots) marks the battlefields in the coming war for coal-export traffic. The East Coast, with 75 million tons per year of loading capacity, has long dominated coal export and is fighting to retain its lead. The principal challenge will come from terminal builders on the Gulf of Mexico, where ports are fed mainly by inland waterways. The West Coast remains a small factor, with only seven million tons of capacity and five million under construction. If all proposed terminals are built, the U.S. will have coal-loading capacity of 628.5 million tons per year—vastly in excess of what will be needed. This survey excludes small terminals under one million tons.

ty at Hampton Roads, one of the biggest projects in the country. In Baltimore, Consolidation Coal, a Conoco subsidiary, has begun building a $100-million terminal that may ultimately handle 12.5 million tons annually from mines in Pennsylvania that the company owns with West German investors. Dravo Corp. is adding 240 barges to its Dravo Mechling fleet plying the inland waterways and, in its capacity as designer and builder, is planning terminals for operators situated from Chesapeake Bay to Puget Sound. On all three coasts, wherever grumbling machinery speeds the black mineral into the holds of waiting colliers, boom times are here and gloom is hard to find.

Crucial in the contest to handle coal traffic is access to the right kind of coal. Hardly a homogeneous product, coal is not even predictably black; most lignites are dark brown. Coal generally falls into two categories. Metallurgical coal is used in steelmaking, and until 1979 almost all U.S. coal exports were of "met" coal. But the projected growth in European and Asian demand is for steam coal, burned mainly by utilities to generate power.

Two important properties are required of steam coal—low sulfur and high energy content. As an antipollution measure, many governments limit sulfur content, often to 1% or less. And the more energy coal produces when burned, the more valuable it is. A buyer must purchase, transport, and handle 300 tons of coal rated at 8,000 BTUs per pound to get the same energy he would derive from 200 tons of 12,000-BTU coal.

A recent national survey of spot prices for steam coal FOB mine gives an idea of the extraordinary range in values. Wyoming and Idaho coal rated at 8,000 BTUs per pound and 1% sulfur recently sold for $7.50 per ton. Illinois coal rated at 10,500 BTUs per pound and 3% sulfur went for $19 per ton. Southern West Virginia and eastern Kentucky coal rated at 12,000 BTUs with a sulfur content of 1% cost $35 per ton. The latter is a hot commodity on any pier in the country.

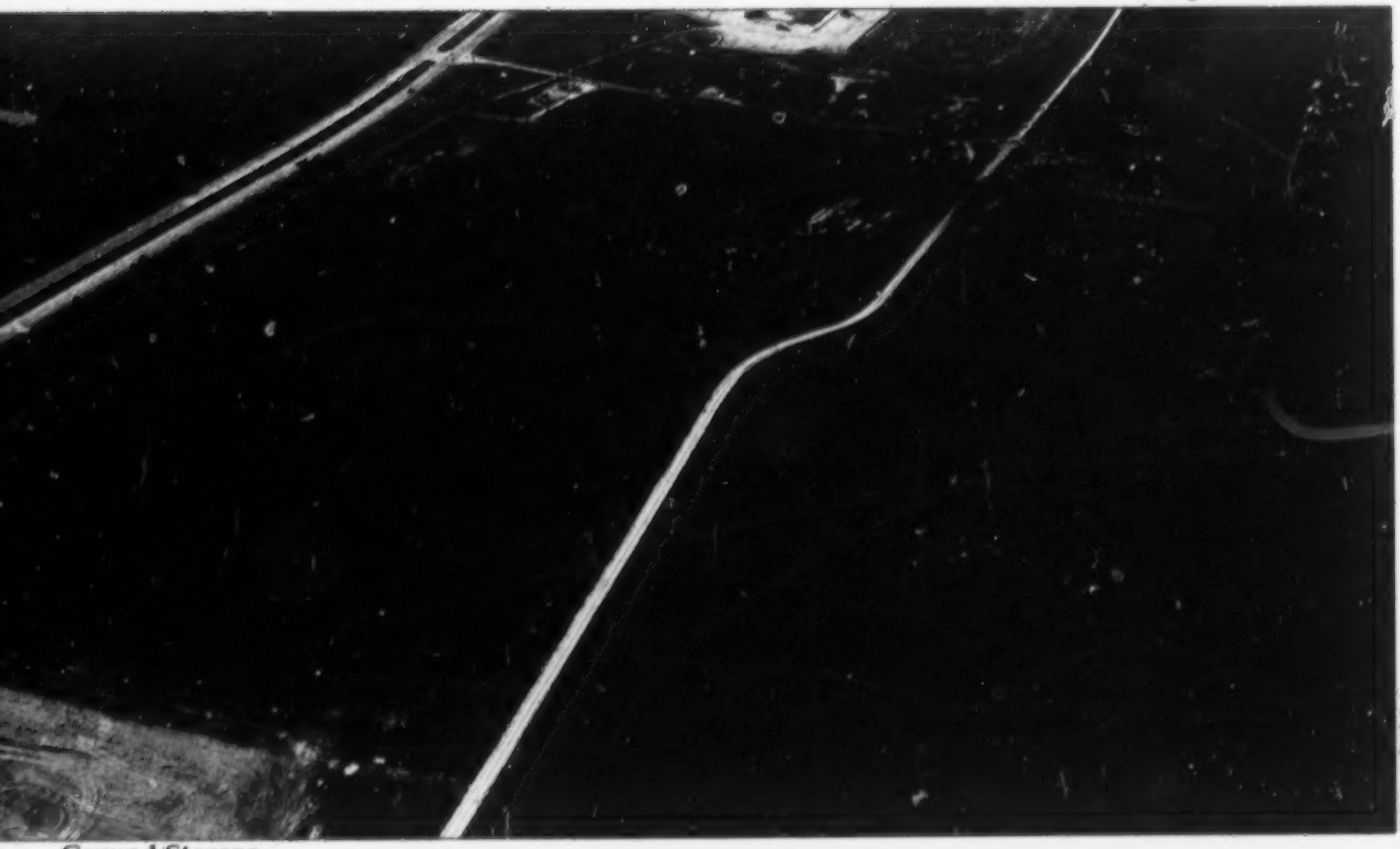
Where advantage lies

Almost as important as coal grade is transportation cost from mine to port. CSX Corp.'s Chessie line and the Norfolk & Western Railway, which haul Appalachian coal to Hampton Roads, charge $14.72 to $15.37 per ton, depending on the distance from mine to terminal. In addition, both railroads charge for loading the coal aboard ship: 46 cents per ton at the N&W terminal and 74 cents at Chessie's. All together, it costs $15.18 to $16.11 to get a ton of Appalachian coal aboard ship at Hampton Roads. At Baltimore, served by the

continued

Research associate: Brian Dumaine

Three Ways to Load



Christopher R. Harris

Ground Storage

Chessie, export rail rates run as low as $14, loading included, while Mobile, Alabama, another low-cost port, has transportation and loading costs as low as $10.25.

These factors give the principal ports exporting Appalachian coal—Hampton Roads, Baltimore, and Mobile—a commanding advantage over competitors. While western coal is available in vast quantities, it has serious drawbacks as an export commodity. The Northern Great Plains deposits are low in energy content, and high-grade Rocky Mountain coal has to travel 1,000 miles, often across mountain peaks, to the nearest port. By contrast, the greatest reserves of low-sulfur, high-BTU coal in the U.S., some 18.7 billion tons, lie in the majestic Appalachian deposits, beginning far up in Pennsylvania and extending down to Alabama. The eastern railroads can carry this premium-quality coal out of the mountains on an easy downhill run to the sea. Little wonder that the ports with access to this coal are fighting to maintain their edge, while every other port in the country is striving to compete with their economics.

These economics have made Chesapeake Bay the Persian Gulf of coal. Its waters carry over four-fifths of all coal shipped overseas from the U.S., more than the exports of any of America's chief rivals—Poland, Australia, and South Africa. Of the two coal ports on the Chesapeake, Hampton Roads is king. The *Monitor* and *Merrimack* fought the battle of the ironclads there, and coal runs as thick as history. Hampton Roads is expected to send 50 million tons abroad this year, almost two-thirds of all U.S. overseas shipments. Rolf Williams, chairman of Anders Williams & Co. and a prominent shipping agent whose livelihood comes from the vessels that call at Hampton Roads, is keenly watching the scramble for coal traffic. "We are very concerned," says Williams. "We will suffer if other ports get the business."

The battle for traffic

The two most important defensive players at Hampton Roads are the Norfolk & Western Railway and the Chessie line, which carry virtually every pound of coal into the harbor. Both are assured of new terminal capacity, which will prepare Hampton Roads, with its tremendous natural advantages, to handle a monumental increase in traffic. The Chessie has sold parcels of land served by its tracks to the A.T. Massey Coal Co. and to Dominion Terminal Corp., a consortium of Westmoreland Coal, Armco, Ashland Coal, and Utah International; both groups will construct terminals of their own. The tracks of the Chessie and Norfolk & Western will feed into the 25-million-ton-per-year superterminal to be developed by the Virginia Port Authority. "If we can get this facility built," says Port Authority Executive Director J. Robert Bray, "we can put Virginia miners to work."

The proposed Port Authority terminal recently won a fierce battle for traffic with a competing proposal put forward by Parsons Brinckerhoff, an engineering and project-development firm. Pittston, Consolidation, Island Creek, and others have agreed to send their coal through the Port Authority terminal, but Parsons Brinckerhoff insists it will still try to develop a facility of its own. Thus Hampton Roads, which now has an export-loading capacity of just over 50 million tons a year, will be adding at least 55 million tons and perhaps

Big Cargo

The classic method is to dump from hopper cars into a conveyor system, as at the Norfolk & Western Railway's Hampton Roads terminal (below). Storing coal by the carload helps the yard select and mix grades to order, but it ties up rolling stock. Modern ground-storage facilities like the one at International Marine Terminals near New Orleans (left) can be more efficient. Railcars or barges unload coal into piles and immediately return for their next shipment. T. Smith Stevedores uses floating derricks in midstream (right) to transfer coal directly from barges to colliers on the Mississippi.

John McGrail

Classification Yard

Christopher R. Harris

Midstream Transfer

90 million. Shipping agent Williams says the new construction leaves the port confident but wary: "We're afraid of Mobile and New Orleans."

Not to mention the harbor just 150 miles up the bay at Baltimore, which is expanding even faster than Hampton Roads and could lure away traffic. With a 157% increase in coal-export capacity already abuilding, Baltimore will soon be able to ship 36 million tons a year. Beyond that, two groups are talking about adding 25 million tons more. Finally, Baltimore has an ace up its sleeve. It is the only major coal port in the nation that has obtained federal authorization for dredging to deepen its channel. If it can get the money to pay for the job (some $322 million is necessary), Baltimore could be in a commanding position to grab traffic.

Ocean-shipping costs are being radically altered by the proliferation of supercolliers, coal's counterpart of the supertankers that revolutionized oil transport in the Sixties and Seventies. The huge coal ships, which at 1,000 feet are almost as long as the Empire State Building is tall, provide significant economies of scale. While many supercolliers are active in world trade, they cannot take on a full load at U.S. coal ports, because at 100,000 deadweight tons they require a channel depth of about 50 feet. No major U.S. coal port is deeper than 45 feet.

Many ports have applied for the right to deepen their channels, but the approval process is still back in the age of the clipper ship. Approvals routinely take 20 years, though Congress is considering legislation to speed up the action. If Baltimore can deepen its channel to 50 feet, a 110,000-ton supercollier loading there could knock $4 off the current $15-a-ton cost of carrying coal to Amsterdam in a 60,000-ton vessel.

Mobile is after Appalachian coal, too. While the port can't economically handle traffic from the northern mines, southern producers in Tuscaloosa and Birmingham are less than 300 miles away by rail or barge. Gerry Robinson, general traffic manager of the Alabama State Docks Department, surveys the machinery that is sprawled over 100 acres of the impressive McDuffie Island export-coal terminal and pronounces it "a classic example of understated southern elegance." But there's nothing understated about McDuffie or what's happening to it. Backed by a $53-million bond issue, the coal station will more than double capacity, to 23.5 million tons, within two years.

A long way to Kenova

One hundred forty miles west, on the lower Mississippi, New Orleans and other cities are enjoying an unprecedented coal-export boom. The activity may seem surprising since the New Orleans area is not the most economical place from which to ship Appalachian coal. The distances make handling it expensive, even when it is carried to portside by low-cost barge. For example, Dravo estimates that coal from the Kenova area in West Virginia, which can be hauled and loaded at Hampton Roads for around $15 a ton, would cost $20 a ton delivered and loaded at New Orleans. In many cases, the port is better situated to handle lower-quality midwestern coal, which can't be economically shipped to the East Coast and so follows the winding track of the inland waterway system that drains from lower Illinois into the Mississippi and the Gulf.

continued

But despite its handicaps, New Orleans shows promise of becoming a muscular, and perhaps disruptive, competitor. European and Asian customers have been flocking there because they have been getting poor service in the East. During the most serious logjams on Chesapeake Bay, foreign coal buyers descended on the ports, aghast at the disruptions. If a vessel is forced to wait in port, its charterer must pay demurrage, a waiting charge, just as a passenger pays the meter on a taxi stuck in traffic. Demurrage on a 60,000-ton collier can come to $15,000 a day. That's 25 cents a ton of coal for each day's waiting, $1.75 a week, $7.50 a month. Before long, demurrage charges can wipe out the East Coast ports' cost advantages.

Mary Ann Heider, manager of the bulk department at Anders Williams & Co. in the port of Hampton Roads, recalls the reaction of a group of visiting foreign customers during the worst delays. "They did some heavy threatening," she remembers. "They screamed and screamed and screamed." Their message: "We've either got to come to some arrangement or we'll go elsewhere."

Elsewhere, in many cases, has been New Orleans. When export demand picked up on the Mississippi, stevedoring companies began loading coal from barges directly onto colliers in the middle of the Mississippi. Midstreaming, as it's called, is a river technique long used for loading metal ore, grain, and meal. Floating derricks with clamshell buckets sling the coal from feeder barges into the ships' holds. Half a dozen stevedoring companies can load coal in midstream, at $2.75 per ton.

In search of security

Land-terminal operators saw the opportunity to get in on the business and are now looking to expand existing facilities or add new ones. No fewer than eight terminals—totaling nearly 50 million tons of capacity—are being planned along the lower Mississippi. "There's almost a Klondike fever in this whole coal thing," says Executive Port Director Edward S. Reed. The largest coal mover will be Louis H. Meece, president of International Marine Terminals, a husky, silver-haired entrepreneur who gained broad experience in coal-terminal facilities as a barge-company executive. Meece is undertaking an expansion that will nearly quadruple capacity at his terminal south of New Orleans to 15 million tons a year.

The question is whether the demand will continue once Baltimore, Hampton Roads, Mobile, and other ports increase their capacities. Marsden W. Miller Jr., president of Miller Coal Systems of Baton Rouge, Louisiana, returned from a recent European tour thinking that foreign customers would be willing to pay a premium for coal shipped through New Orleans to be certain that an alternative to the eastern ports is available. "As long as you're within a dollar or two," he says, "what the buyer wants is security."

But if terminal operators don't get long-term commitments from foreign customers, they may find their facilities operating way below capacity. Magnolia Coal Co. has broken ground on new facilities without long-term contracts, and U.S. Steel's River & Gulf Transportation Co. is thinking about doing the same. Whether that makes sense will depend on how many terminal operators have similar ideas—and whether overcapacity gives for-

continued

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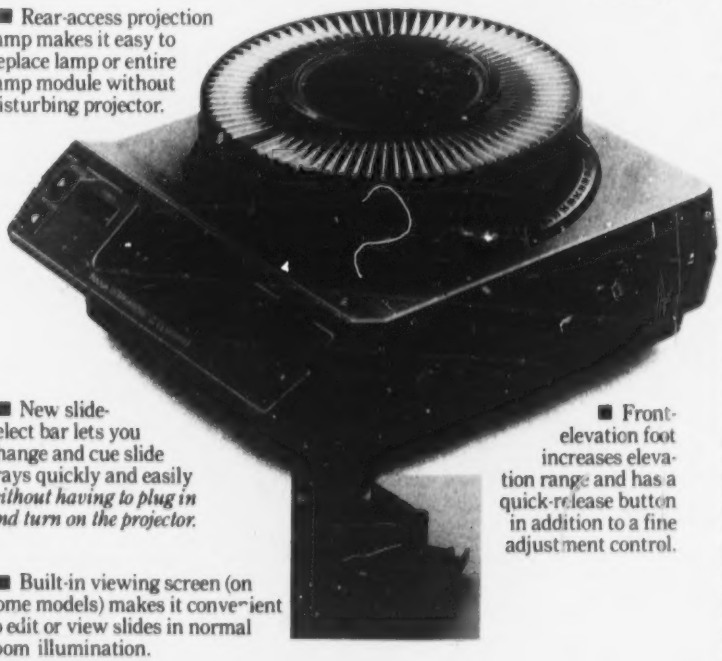

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As if anticipating a future of overcapacity and rate wars, the terminal operators are looking hard at their economics. Meece believes that new eastern coal terminals will be more expensive than present facilities because they will have heavier capital costs to recover. While the loading fee at the N&W terminal is now only 46 cents, he thinks new East Coast terminals will have to charge $3 to $4. That could be enough to destroy their transportation-cost advantage.

Here come the Indians

In answer, eastern terminal developers are negotiating with the N&W and the Chessie to cut the costs of moving coal from mine to port. For example, the Chessie says it is considering a reduction of about $2 a ton in the cost of shipping coal by unit train into Consolidation Coal's new terminal in Baltimore. In answer to *that*, New Orleans operators are continually pressing for lower unit-tow rates on the Mississippi and other rivers. With many rates still being considered, it is too early to tell whose economics may turn out most favorable.

Other competitors could come out of nowhere. D. K. Ludwig, 84, plans to anchor a warehouse ship in Delaware Bay that could receive coal from barges and transfer it to 140,000-ton supercolliers. The Tulalip Indian tribe has retained Dravo to study the feasibility of building a 15-million-ton terminal on tribal land at Possession Sound, Washington. And the Sun Eel Shipping Co. of South Korea has obtained a contract to export coal at Seward, Alaska.

New York's harbor handles hardly any coal today, but that doesn't mean it wouldn't love to. The Port of New York and New Jersey has a marvelous advantage. The 12-mile channel from Ambrose Light to the piers on Staten Island and Port Jersey is much shorter than the entrances to other U.S. coal ports. New York could be dredged to 60 feet for less money than it would take to dredge any other port to 50 feet. A port 60 feet deep could accommodate supercolliers of 200,000 deadweight tons, nearly twice the size of any that has so far entered a U.S. harbor.

Local authorities are now thinking about putting up the $140 million needed to deepen the channel themselves. That would avoid the lengthy federal authorization process. New York officials are sounding out foreign coal buyers to see if they would be interested in contracting for coal that Conrail could haul from Appalachia to the harbor. If they do show interest, New York could build 24 million tons of terminal capacity.

Where chips are piled

With coal terminals being built or planned at 29 harbors, the winners are hard to pick, but it's clear where the betting is heaviest. The chips are piled highest on the old and classic formula: coal from the Appalachian fields moving through Chesapeake Bay. As the market explodes, Hampton Roads will surely find its dominance eroded, but it will still reign as king. Elsewhere, terminals that have not yet broken ground face the risk of being instantaneously superfluous. Those that build without having their traffic ensured by long-term contract face cutthroat competition. Indeed, the coal trade looks like a marvelous opportunity. For the brave. F

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